

**STATE BOARD OF EQUALIZATION**

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June 20, 1996

E. L. Sorensen, Jr.
Executive Director

Mr. J--- M. S---
Law Offices of J--- M. S---, Inc.
XXX N. --- --- Avenue
--- ---, California XXXXX-XXXX

Re: Royalty Payments

Dear Mr. S---:

This is in response to your letter dated March 28, 1996, regarding the application of tax on the sale of liquid nitrogen injection equipment by your client. You state that your client sells liquid nitrogen injection equipment for use by the canning industry. The equipment is supplied by a manufacturer who holds the patent on the equipment. After the sale of the equipment by your client, the manufacturer enters into a separate license agreement with the purchaser. Pursuant to that agreement, quarterly royalty payments for the use of the equipment are paid by the purchaser to the manufacturer. Your client collects the royalty payments on behalf of the manufacturer and is compensated for the collection work by retaining 15% of the royalty payment as a commission.

You ask whether sales tax applies to the 15 percent commission received by your client. You also ask whether 100 percent of the royalties paid by the purchaser should be included in the gross receipts of your client as the retailer of the equipment.

DISCUSSION

Sales tax is imposed on a retailer's gross receipts from the retail sale of tangible personal property in California unless the sale is specifically exempt from taxation by statute. (Rev. & Tax. Code § 6051.) Gross receipts include the total amount received with respect to a sale, with no deduction for the cost of the materials, service or expense of the retailer passed on to the purchaser unless there is a specific statutory exclusion. (Rev. & Tax. Code § 6012.) Royalty payments received in connection with a retail sale of a patented equipment are included in a retailer's gross receipts. (See BTLG Annot. 295.0460 (7/8/55).)

As you know, your client is liable for sales tax on its retail sales of liquid nitrogen injection equipment. For sales and use tax purposes, the total amount charged to the purchaser for the right to use the equipment is part of the sale price of the equipment and is included in gross receipts. (See BTLG Annots. 295.0520 (2/19/54); 295.0540 (5/10/54).) Based on the facts you have provided, our understanding is that the purchaser could not use the equipment for the purpose for which it is intended without paying royalties to the manufacturer who holds the patent on the equipment. (See BTLG Annot. 295.0480 (9/21/66).) Under such circumstances, sales tax is measured by the total amount of the sale price of the equipment, including 100 percent of the royalties paid by the purchaser of which 15 percent is retained by your client. As the retailer of the equipment, your client must report the royalty payments in the quarter in which the payments become due. (BTLG Annots. 295.0570 (1/4/79), 295.0575 (5/17/88).)

For your information, I have enclosed a copy of each Business Taxes Law Guide Annotation cited above. If you have any further questions, please write again.

Sincerely,

Sophia H. Chung
Tax Counsel

SHC:rz

Enclosures: Business Taxes Law Guide Annotations

cc: --- --- District Administrator (--)